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Temporary Assignments & Per Diem Reimbursements

When an employee is sent to temporarily work at a location away from the home office, the contractor must pay for various travel, lodging, and incidental costs. In this type of situation, a contractor must determine what amounts are deductible to the company and what amounts (if any) may be taxable to the employee.

This article will review the complex tax impacts of temporary work assignments to maximize the benefits to employers and employees.

Basic Guidance

What types of expenses are deductible as ordinary, necessary, and reasonable business travel expenses while traveling away from home? The IRS supplies the following list as basic guidance:¹

- Travel by airplane, train, bus, or car between the employee's home and business destination.
- Fares for taxis or other types of transportation between the airport or train station and hotel, the hotel and the work location, and from one customer to another or from one place of business to another.
- Shipping of baggage and certain other materials between the regular and temporary work locations.
- Vehicle usage while at the business destination; actual expenses or the standard mileage rate can be deducted, as well as business-related tolls and parking fees. If the vehicle is rented, then only the business-use portion can be deducted.
- Meals and lodging.
- Dry cleaning and laundry.
- Business calls while on the trip, including other business communications (e.g., fax).
- Tips paid for services related to any of these expenses.
- Other similar ordinary and necessary expenses related to business travel (e.g., transportation to and from a business meal).

Temporary vs. Permanent Assignments

Reimbursement of these types of travel expenses can be deductible to a contractor for an employee who works away from home on a *temporary assignment*, which the IRS defines as less than one year.² When employment away from the employee's tax home commences, the contractor must determine whether a job is realistically expected to last less than one year based on current facts and circumstances.³

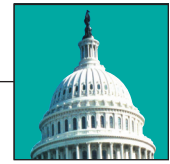
However, once that realistic expectation changes to more than one year, the assignment is no longer temporary.⁴ When the assignment becomes permanent, any expenses for travel away from home are no longer deductible as travel expenses by the employer. Instead, these expenses must be included in the employee's compensation. The employer still receives the deduction, but it is characterized as compensation. Moreover, the employer may have to consider grossing-up the amounts so that the employee is "made whole" after income and FICA taxes.

Naturally, contractors want to ensure that assignments, when feasible, are less than one year in order to qualify as temporary.

Consider the following example: Employee Yellow is assigned to provide assistance on a large-scale project that is expected to last for 18 months. Employee Yellow plans to spend two months at his regular office doing preliminary research and preparation, followed by 10 months at one "on site" work location and then four months at a second "on site" work location.

Although the project is expected to last for 18 months, and although Employee Yellow's "on site" visits are expected to last for 16 months, the "clock" on the one-year limitation does not start ticking until he commences employment at a particular location. Because the employment at each of the "on site" work locations is expected to last (and does in fact last) for one year or less, the employment at each of the sites is temporary.⁵

In another situation where the employee returns to the *same* location instead of traveling to different ones, there



is limited guidance as to the duration of a break in service before an employee can return to work in another location for temporary status to restart.

According to the IRS, “Because of the highly individual nature of the factual inquiry involved, the IRS has not issued general guidance in this area. The determination whether a break is so significant that it warrants treating two periods of employment as separate periods or constitutes a hiatus in one continuous period of employment is made by taking into account all facts and circumstances.”⁶

The IRS does not provide a bright line or safe harbor rule; it only offers two timeframes: three weeks and seven months. In an internal document for its auditors, the IRS states that a break of less than three weeks would not “stop the clock” running toward the one-year threshold.

However, a break of seven continuous months – during which time the employee was not at the location in question – would be treated as a significant break (i.e., the clock can restart toward a new one-year threshold).⁷

Proper Documentation

Generally, employees need to supply adequate documentation to support the deductions. While documentation requirements can be mitigated through the use of *per diems* (discussed later), the main substantiation areas are: the amount of the expense; the time and place of the expenses; and the business purpose of the expense.

As part of these requirements, additional elements must also be substantiated for travel expenses, including:⁸

- Amount of each away-from-home traveling expenditure (e.g., daily cost of transportation or lodging). Daily totals may be shown for taxpayer’s incidental expenditures if separated into reasonable categories (e.g., meals, gasoline and oil, taxi fares);
- Date of departure and return for each trip away from home;
- Number of days away from home spent on business;
- City, town, etc., of destination or locality of travel; and
- Business purpose – business reason for, or business benefit derived or expected from, the trip.

So, how can the employer and employee ensure that reimbursements for travel away from home are not subject to FICA taxes?

Accountable & Non-Accountable Plans

The IRS characterizes reimbursement plans as either Accountable Plans or Non-Accountable Plans.⁹ Under an accountable plan, if the employee supplies adequate substantiation for the company’s reimbursement of travel expenses, then the employee’s reimbursement is not taxable and not subject to FICA taxes.¹⁰

If the reimbursements are not supported by adequate documentation, then the plan is characterized as non-accountable and the reimbursements are subject to taxation as additional compensation to the employee; both the employer and employee are subject to FICA taxes on the amounts.

To be an accountable plan, the employer’s reimbursement or allowance arrangement must include all of the following rules:¹¹

- 1) Expenses must have a business connection: expenses are paid or incurred while performing services as an employee.¹²
- 2) The employee must adequately account to its employer for these expenses within a reasonable period of time (generally 60 days).¹³
- 3) The employee must return any excess reimbursement or allowance within a reasonable period of time (generally within 120 days).¹⁴

If all three rules are not followed consistently, then specific expenses (or worse, the entire plan) could be treated as paid under a non-accountable plan, resulting in taxable compensation to the employee as well as FICA tax to the employee and employer for those specific expenditures. Moreover, if a plan is later determined to be non-accountable, then the employer could be held liable for payroll taxes related to the previously untaxed reimbursements.

Per Diem Rates

As previously mentioned, employers can choose to simplify their reimbursement policies by paying a *per diem* rate for meals and lodging.

Instead of reimbursing actual expenditures for travel away from home for lodging and meals and incidental expenses (M&IE), an employer may pay a *per diem*. Incidental expenses only include fees and tips given to porters, baggage, carriers, hotel staff, and staff on ships.¹⁵

An employee receiving a *per diem* is considered to have substantiated the amount of expense up to the *per diem* amount.

This eliminates the need for the employee to submit receipts to the employer. But only the amount of the expense is considered substantiated.¹⁶ The employee and employer must still substantiate the other required elements – namely time, place, and business purpose.

Regular Method

If the reimbursed amounts to the employee do not exceed IRS-approved reimbursed maximum rates for the locality, then the reimbursement is treated as if it were an accountable plan with the employee supplying simplified substantiation (time, place, and business purpose). These reimbursements are not subjected to payroll tax withholding and not included in W-2 income.

Under this regular method, the IRS approved *per diem* maximum is the same as the U.S. General Services Administration's (GSA) *per diem* rate paid to its workers on travel status. This rate differs by locale, and the GSA supplies several *per diem* rates that the contractor can look up.¹⁷

High-Low Method

Under the high-low substantiation method, there is one rate for all high-cost areas within the continental U.S. (CONUS) and another rate for all other areas in the CONUS.¹⁸ Under this optional method (effective 10/1/15)¹⁹ the high-cost area *per diem* is \$275 per day (\$207 for lodging and \$68 for M&IE). For all other areas, the rate is \$185 (\$128 for lodging and \$57 for M&IE). Periodically, the IRS will publish changes to high-cost areas in the CONUS. For example, Hershey, PA was added and New Orleans, LA was removed as of October 2015.²⁰

The *per diem* portion for meals is subject to 50% add-back similar to other deductions for meals and entertainment. Thus, the employer must treat M&IE allowances as food and beverage subject to the 50% deduction limit on meal expenses.²¹

Other rules mitigate the impact of the 50% reduction by allowing for a portion of incidental expenses to be broken out.²² Note that if the *per diem* is based on an amount other than the federal stated *per diem*, 40% of the *per diem* is considered to be meals for the IRC § 274 limitation (50%).²³

Summary

When a contractor is confronted with work away from home for its employees, it is paramount to document whether or not assignments are in fact temporary as defined by the IRS.

CFMs must focus on documentation requirements to ensure that temporary travel expenses are deductible and ancillary taxes are mitigated for both the company and its employees. Further, such decisions as the type of reimbursement plan (accountable vs. non-accountable), the nature of reimbursements (actual or *per diem*), and potentially the choice of *per diem* method (regular or high-low) also affect the tax implications when employees work away from home. ■

Endnotes

1. www.irs.gov/taxtopics/tc511.html.
2. Rev. Rul. 99-7.
3. *Ibid.*
4. *Ibid.*
5. IRS Chief Counsel Advice 200027047.
6. IRS Chief Counsel Advice 200026025.
7. *Ibid.*
8. Treas. Reg. 1.274-5T(b)(2).
9. Treas. Reg. 1.62-2(c)(2) and (3).
10. Rev. Rul. 90-23.
11. Treas. Reg. 1.62-2(d).
12. *Ibid.*
13. Treas. Reg. 1.62-2(e).
14. Treas. Reg. 1.62-2(f).
15. Rev. Proc. 2011-47 Sec. 4.05.
16. Rev. Proc. 2011-47 Sec. 4.01.
17. www.gsa.gov.
18. Rev. Proc. 2011-47.
19. IRS Notice 2015-63.
20. *Ibid.*
21. Rev. Proc. 2011-47, Sec. 6.05.
22. Rev. Proc. 2011-47, Sec. 6.05(5).
23. Rev. Proc. 2011-47.

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